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June 28, 2007

Mr. J. Clark Kelso, Chairperson, Technology Services Board
c/o McGeorge School of Law
3200 Fifth Avenue
Sacramento, CA 95817

Dear Mr. Kelso:

Report to the Technology Services Board for the Department of Technology Services' Statewide Email Rate Proposal

Per Section 11540(c) of the Government Code, the Department of Finance provides the attached Report to the Technology Services Board for the Department of Technology Services' Statewide Email Rate Proposal

If you have any questions, please contact Helen Woodman at (916) 445-1777, extension 3240, or by e-mail at Helen.Woodman@dof.ca.gov.

Sincerely,

Mark Hill

Mark Hill
Program Budget Manager
Business, Transportation and Housing

Attachment

cc: Honorable Rosario Marin, Secretary, State and Consumer Services Agency
Mr. Andrew Armani, Agency Information Officer, State and Consumer Services Agency
Mr. P.K. Agarwal, Director, Department of Technology Services
Mr. Glen Matsuoka, Assistance Director, Administration, Department of Technology Services
Mr. Larry Mills, Budget Officer, Department of Technology Services

Department of Finance
Report to the Technology Services Board
For the Department of Technology Services'
Statewide Email Rate Proposal
June 28, 2007

Introduction

Government Code Section 11540(b) requires the Department of Finance (Finance) to prepare a report to the Technology Services Board (TSB) of the Department of Technology Services (DTS) evaluating the reasonableness of rates proposed by the DTS, and any significant impact the rates are likely to have upon the budgets of other departments. The DTS has submitted a rate package and business plan in support of their proposed Statewide Email (SWE) service offering. This report provides Finance's evaluation of the reasonableness of this proposed rate within the context of the business plan.

Background

The DTS currently provides email services to a relatively small group of customers totaling approximately 19,000[1] mailboxes. The DTS proposes to enhance and upgrade this email service, title it SWE, and make it available to any interested California state agency.

Proposed Rate for Statewide Email and Related Services

Email Rate

The DTS proposes to offer SWE at a rate of $6.00 per mailbox per month plus $18.35 per gigabyte of storage per month. The rate currently charged to existing email customers is $8.05 per mailbox per month plus $26.60 per gigabyte of storage per month. The proposed rate utilizes the temporary subsidization model of DTS' rate methodology.

In order for the proposed rate to be sufficient to recover costs, the DTS must achieve a targeted volume of 50,000 mailboxes by October 2009 (the DTS notes that it will actually achieve its cost recovery objective at 45,000 mailboxes but uses 50,000 for the purposes of this analysis). The rate package proposes a 34 month subsidization period from January 2007 through October 2009. The rate change will be retroactive to January 1, 2007. The amount subsidized is estimated to be $1.4 million or one quarter of one percent of the total cost of all DTS services. The DTS states in their rate proposal that this level of subsidization does not create a cash flow problem. If the anticipated adoption level is not achieved, the DTS will need to increase the rates charged to customers in order to recover total costs. For example, if the adoption rate only reaches 30,000 mailboxes, the DTS will have to increase the rate charged to its customers to $7.74 per mailbox plus storage.

Email Migration

In addition to the monthly costs, there will be a one-time charge for customers to migrate to SWE from their existing email systems. This cost will vary from customer to customer based on geography, the source email system, the migration approach

[1] The DTS states there are 18,868 mailboxes as of June 1, 2007.

and availability of customer resources. The DTS will charge customers only for the actual cost of migration, and allow payment over a 24 month period. The DTS estimates the cost of migration will be $42 per mailbox for customers already using Microsoft Exchange and $62 per mailbox for customers using a non-Microsoft Exchange environment.

Mobile Devices
The DTS proposes a revised rate for mobile devices (Blackberries) of $7.50 per user per month. The rate charged to existing customers is $2.38 per user which only captures licensing costs, leaving staff, hardware and remaining software costs to be subsidized through other rates. The proposed rate for mobile devices utilizes the service methodology model of DTS' rate methodology and will align the rate to reflect the actual cost of providing the service.

Analysis of the Proposed Rate for Statewide Email and Related Services

Email Rate
The proposed rate appears to satisfactorily conform to the temporary subsidization model of the DTS' rate methodology. While we believe the rates are generally reasonable, we do have a concern with the DTS' ability to achieve its goals for customer utilization. We are also concerned because the proposal suggests that a mandate for departments to use the email service may be necessary to achieve the anticipated utilization levels, indicating their uncertainty regarding customer interest in this service.

Finance strongly opposes mandating departments to utilize SWE and believes the DTS should be a service provider that delivers compelling and cost effective services such that mandated usage is not necessary. The DTS states that the proposed rate for SWE is competitive[2] but whether or not migrating to SWE would be advantageous would have to be determined by departments on an individual basis. Email environments vary widely from department to department, and it would be necessary for a department to perform its own cost benefit analysis to determine whether migrating to SWE will save money. In addition, there are other factors that departments will likely consider when deciding to use SWE such as the quality of service, DTS' responsiveness to service requests, retaining autonomy over their email systems, and the inconvenience and risks associated with migration.

The DTS has indicated that they are in discussions with the Department of Motor Vehicles (DMV) and the Department of Toxic Substances Control, but have not provided confirmation of these departments as new customers. Previously, the DTS engaged in discussions with the Department of Corrections and Rehabilitation (CDCR), but we understand that the CDCR has not made a commitment to utilize the service at this time. According to the DTS, there are six other customers in addition to DMV and Toxics who have expressed interest in SWE, with a combined total of 5,500 mailboxes. Again, it is unknown at this time if any of these departments will actually utilize SWE.

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[2] The California Performance Review "SO29 Consolidation of E-Mail Will Improve Services and Save the State Millions" cites costs ranging from $12 per user per month to a high of $18 per user per month, for departments that host their own email services.

Mobile Devices

The proposed rate appears to satisfactorily conform to the service model of the DTS' rate methodology, which is the total cost of providing the service divided by the number of billable units. However, this rate is based on the projected number of users increasing from 385[3] in July 2007 to 1,790 in June 2008 and includes 1,200 mobile device users from the CDCR. If this level of adoption is not achieved, the DTS will have to charge a higher rate in order to recover the costs for this service. The DTS states that the proposed rate will be re-evaluated if the number of users deviates significantly from their projections. It should be noted that the DTS is currently subsidizing this service because it is only charging existing mobile device customers for licensing costs, leaving staff, hardware and other software costs to be absorbed elsewhere.

Analysis of Significant Impact on Budgets of Other Departments

Email Rate

We do not believe this proposed rate creates a significant impact on the budgets of other departments because:

1) Existing customers will receive a reduced rate, so this proposal would actually lower their costs for email services, and
2) SWE is a voluntary service for new customers; departments are not required to utilize it.

The DTS has communicated to Finance that in the event of lower than targeted adoption, they will take "corrective action" consisting of one of the following:

1) Recommend increased funding for existing customers to pay the higher rate;
2) Reduce service levels to reduce costs;
3) Discontinue the service; or
4) Mandate the service via a policy decision of some sort.

Mobile Devices

The current number of mobile device users supported by the DTS is relatively small, and even if this number were to increase significantly in the near future, the costs involved do not appear to be large enough to significantly impact any of their current customers. The most heavily impacted department at this point is the Office of Systems Integration (OSI), who, with 99 users, would see their mobile device cost increase by $6,083 per year. However, based on a review of the effect of the proposed rate changes provided in the rate package, the proposed increase in the mobile device rate is generally offset by savings in the proposed mailbox and storage rates. These savings range from $43 per month for the California Workforce Investment Board with 23 mailboxes and 5 mobile devices, to $17,862[4] per month for the Employment Development Department with 8,713 mailboxes and 89 mobile devices. The OSI monthly savings would be $4,291.

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[3] The DTS states there are 432 mobile devices as of June 1, 2007.

[4] Savings likely to be higher because storage utilization was not available and therefore not included in this amount.

Conclusion

Email Rate

The DTS' proposed rate of $6.00 per mailbox per month plus $18.35 per gigabyte of storage per month for SWE assumes that the targeted utilization level of 50,000 mailboxes is reached by October 2009. The rate package proposes a rate of $7.74 per mailbox per month if the utilization level only reaches 30,000. It should be noted that this rate is still less than the current rate of $8.05 per mailbox per month plus $26.60 per gigabyte of storage per month existing DTS email customers are paying. Rates for utilization levels below 30,000 or between 30,000 and 50,000 were not provided.

As a low level of utilization is a real possibility given the current limited level of interest, the TSB should consider the DTS' proposed "corrective action" as part of its consideration of this rate proposal. Further, proposing to make the rate retroactive to January 1, 2007, has reduced the amount of time available for the DTS to reach its utilization goals from 34 months to 28 months.

We believe the DTS should alert current and potential new customers to the variable nature of the proposed rates and how the rates or service levels may change based on different levels of utilization, in order for those departments to make an informed decision.

We also would encourage the TSB to consider another alternative rather than approving the proposed rates at this time. The TSB could direct the DTS to secure customer commitments for 11,000 additional users, bringing the total to 30,000 before approving the rate package. This approach would reduce the potential for rate volatility to existing customers by ensuring the DTS has achieved a utilization threshold that can sustain a monthly rate that is less than currently charged for email services.

Mobile Devices

The proposed rate for mobile devices is based on a formula (total cost of service divided by volume of billable units) which can be adjusted to accommodate varying levels of utilization. The cost components of this service appear to be valid. However, this rate is based on a very optimistic increase in utilization including 1,200 mobile devices from the CDCR, which has not committed to utilizing SWE at this time. Finance has a concern that this proposed rate may be adjusted upward significantly in the event of lower than projected utilization of this service, and recommends that the TSB factor this into their consideration of this rate.